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Chain Store Age
EXECUTIVE
with Shopping Center Age
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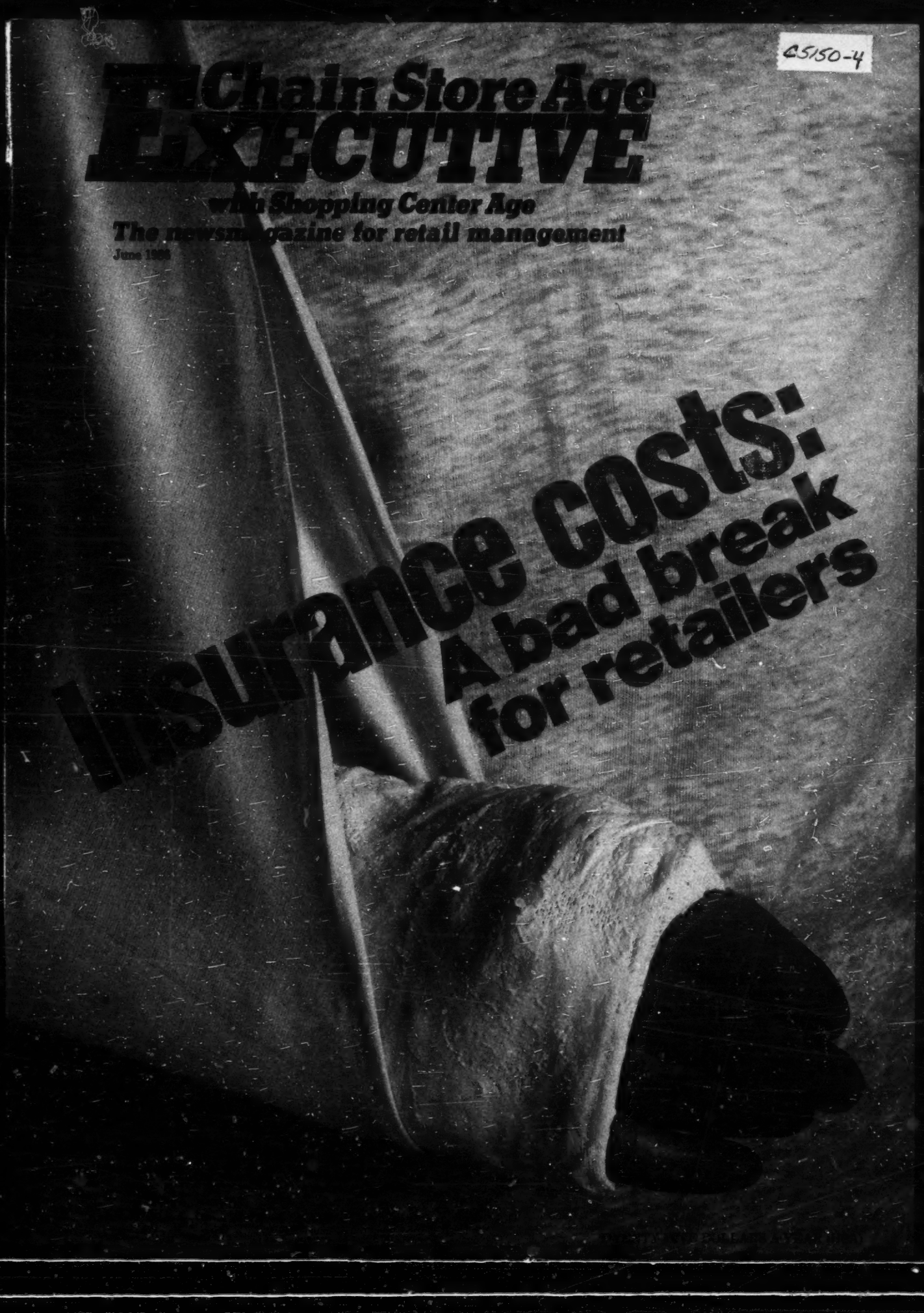
Insurance costs: A bad break for retailers



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A BAD BREAK FOR RETAILERS

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SHOPPING CENTER AGE

URBAN CENTERS: NEW RETAIL OPTIONS

Developers hope to lure today's generation with a "new city" concept. They are creating master-planned projects combining retail, office and residential space into a single entity. Customers enjoy the convenience of being able to live—and to shop—near where they work. 23

Company executives have three main causes of concern:

- the cost increases are dramatic—as recently as 1983, retailers were spending 34¢ per $100 in sales for insurance coverage. Today that figure is likely to be 50¢ or 51¢;
- the scope of coverage has decreased dramatically, thereby exposing corporate assets and earnings to costly lawsuits; and,
- closer to home, the cost of directors and officers liability insurance has risen six- or seven-fold, while coverage has decreased.

A limited knowledge of insurance, coupled with reports featured in the media as of late, leads one to assume that liability insurance is the sole culprit. While that may be the sexiest, most publicized issue, it is not, however, the whole story. In reality, the cost of *all* forms of insurance has gone up substantially, some to the point of bordering on the ridiculous *(see accompanying story and chart)*.

The reasons, say observers, are a combination of past and present market conditions that make for the current hard insurance market:

- several years ago when interest rates were high, insurance companies over-estimated the return that could be realized by investing premiums. It never came to pass and now they are trying to recoup their losses.
- current low interest rates don't allow for major returns, thereby necessitating higher premiums.
- a number of insurance companies have gone bankrupt or gotten out of the business; not only has competition lessened considerably, capacity has diminished.

The issue of capacity essentially means the universe of coverage dollars is governed by the amount of capital controlled by the insurance companies. By law, the amount of premium an insurance company is allowed to accept is limited by its capital. Fewer companies means less capital, which, in turn, means less in premiums, which results in less financial coverage.

The bottom line: there's less insurance to be had and what's available has already become more expensive. Many observers, however, debate whether enough insurance companies have actually pulled out of the market to impact costs to the degree they currently have.

This current tight market for insurance is a whole new ball game for retailers, who are traditionally considered tough insurance negotiators who usually get their way. In the past, J. C. Penney, like many retailers, had its choice of what insurance company it wanted as its carrier; it could dictate terms and conditions and negotiate premiums.

Insurance costs: Where does the money go?

The reason retailers are being so severely impacted by high insurance increases is two-fold: Premiums for all types of insurance are increasing. At the same time, insurance companies have raised the maximum dollar amount of losses a retailer must assume for his primary casualties—workers compensation and public liability.

Only a handful of years ago, underwriters were quick to give a retailer a break. If the retailer expected to have a minimum of $3,000,000 in primary casualty losses, he could get a policy that only held him responsible for a $2,500,000. Competition was hot and interest rates were high. The underwriter figured he could make more than enough to offset the difference by investing the retailer's money.

Today, that scenario is rarely seen. If the retailer is likely to incur a minimum of $3,000,000 in losses, the insurance company will charge him the full amount or close to it. The charge to service those losses has increased as well.

Additionally, smaller retailers who once were able to get guaranteed cost insurance (which typically would cost even less than 34¢ per $100 in sales), are no longer able to do so. Under a guaranteed cost policy, a fixed premium covers both primary casualty losses and the service fees.

Curiously, despite the media attention paid to inflated liability awards, retailers report that their primary casualty losses are about equally divided between workers compensation and public liability. While public liability losses *have* increased, so have the costs of medical expenses and lost work time payments for workers.

The increases for medical treatment has outpaced inflation. At the same time, wages have risen, meaning that payment for lost time has risen. Additionally, more injured workers are using lawyers to plead their cases before the workers compensation board; in those situations the board usually grants higher awards. These factors are increasing the cost of workers compensation dramatically—as dramatically as the public liability is going up.

Insurance costs for a hypothetical $1 billion retailer

Type of insurance	1985*	1986**	Percentage increase
Workers comp., public liability	$2,500,000	$3,900,000	28.0%
Service fee	300,000	450,000	50.0
First layer umbrella	100,000	400,000	300.0
Excess umbrella	50,000	500,000	900.0
Property	400,000	520,000	300.0
Directors and officers liability	25,000	150,000	500.0
Miscellaneous	50,000	100,000	100.0
Total	$3,425,000	$5,120,000	49.5%

*Most likely to be a cost-plus program with a built-in maximum, retrospectively rated
**Most likely to be a cost-plus program without a maximum or a maximum high enough to cover all or most losses, retrospectively rated
Source: Tillinghast, Nelson & Warren

The total increases take their toll on a retailer's pre-tax earnings. A retailer doing $1 billion in sales can expect his insurance costs to rise to approximately $5.12 million this year. Assuming that pre-tax profits run about $54 million, the increase represents a rise from $3.4 million, or 6.34% of pre-tax earnings to 9.48%, or an additional $1.7 million.